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Over Your Dead Body: What if a Stranger Had a Life Insurance Policy on You?

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Birth of a Notion: STOLIs harken back to 18th-century England, when speculators turned life insurance into a form of gambling by taking out policies on prominent nobles without their knowledge, in hopes of cashing in on their deaths.

Photo by Rue des Archives/The Granger Collection, New York

The insurance broker's offer to Sylvia Schroeder of Sacramento, Calif., came out of the blue. He had a tantalizing financial proposal: If Schroeder, 73, would agree to take out a life insurance policy, an investor group would not only cover the premiums but also pay her a five- or six-figure bonus upfront. In exchange, after two years Schroeder would quietly sign the policy over to the investors, who would then become its beneficiaries. When she died, they—not her husband or family—would collect the policy's multimillion-dollar death benefit.

Schroeder was wary. "They were going to turn around and sell this piece of paper to someone else, so who knows who would end up with it?" says her daughter, Clara. "It almost gave you the feeling that you'd have to watch your back. It was very creepy."

Welcome to the shadowy world of "stranger-originated life insurance," or STOLI. Also known as speculator-initiated life insurance (SPINLIFE) or investor-originated life insurance (IOLI), STOLI is a little-understood type of financial transaction that promises older people what seems like easy money for little more effort than filling out an insurance application. The investors—the "strangers" who give STOLI its name—are gambling that the people who take out the policies will die before the premiums eat much of the windfall that the investors stand to gain.

"Basically, they want to make an investment in your death," says Frank N. Darras, a lawyer in Ontario, Calif., who is widely recognized as an expert in disability and long-term care insurance.

Not surprisingly, STOLI is vehemently opposed by the mainstream insurance industry, which argues that it's fraud for a person to buy a policy with only a profit—not an insurance—motive. There's also the fear that industry profits will sag as insurers, faced with fewer policies being dropped for personal or financial reasons, have to pay out more in death benefits than their actuarial models anticipate. In large part, state lawmakers have jumped on the anti-STOLI bandwagon. In fact, at least 11 states have banned STOLI arrangements outright, and at least 20 states are considering such legislation.

Last year, one STOLI deal was briefly in the headlines when CNN talk show host Larry King filed a lawsuit against insurance agent Alan Meltzer and Bethesda, Md.-based Meltzer Group Inc. alleging, among other things, that he'd been misled into taking out a $10 million insurance policy.

"Larry King is an intelligent gentleman who earns a substantial income," Darras says. "For him to come back and say that he was duped, that it was confusing—well, if he didn't understand the fine print, how in the world is Mom going to understand what is going on?"

Birth of a Notion

The basic idea of STOLI harks back to 18th-century England, where speculators turned life insurance into a form of gambling by taking out policies on nobles and other prominent people without their knowledge, in hopes of cashing in on their deaths. The fear that this might lead to murder prompted the British courts to create the concept of "insurable interest," which eventually became the legal standard in the United States as well. In its simplest terms, this means that anyone who takes out a policy must have an interest in the insured person's staying alive.

Usually this isn't a problem, because most people take out life insurance policies on themselves, with their own family members as the beneficiaries. But here's where things get complicated. As the U.S. Supreme Court established in 1911, the person who takes out a policy legally owns it and also has the right to sell it, after the customary two-year period during which the insurance company can contest the policyholder's application information.

The reselling of insurance policies became common practice in the 1980s, when AIDS patients in failing health, desperate for money to pay for medical care or other needs, began selling their life insurance to investors for as little as 50 cents on the dollar. Such viatical settlements, as they are called, differ from STOLI arrangements in that the insured individuals originally bought the policies themselves without the intention of reselling them.

In the 1990s, drug therapies improved the survival rates of people with HIV and reduced their need to get money out of their life insurance policies. So investors carved out a new market by buying policies from older people who no longer could afford the premiums, who no longer needed the insurance (because a beneficiary had died, for example) or who simply wanted more money for retirement. Life settlements, as such transactions are called, have grown into a legitimate multibillion-dollar industry.

But along the way, some entrepreneurs came up with a devious variation on the conventional life settlement by persuading older people—typically 65 to 85 years old—to take out life insurance policies expressly for the purpose of reselling them. They typically target well-to-do individuals who can qualify for policies with multimillion-dollar death benefits. The marketers of STOLI deals tend to keep low profiles, and the arrangements are kept secret from the insurance companies that underwrite the policies.

As a result, no one is sure just how large the STOLI market has become. But almost everyone agrees that it's very large. California state Sen. Mike Machado, D, who's trying to outlaw the practice, has estimated that the nation's insurance companies will pay out as much as $100 billion to STOLI investors over the next decade. Darras, who likens the STOLI industry to "a runaway freight train," says that he gets as many as 20 calls a month from older clients who have been approached with such deals.

"Anecdotally, we've heard that it's big in Florida and Arizona, where you have a lot of wealthy retirees," says Jack Dolan, a spokesman for the American Council of Life Insurers. "They're approaching older people on golf courses. That's a good place to look, because they want people who are healthy enough to get a policy, but not so healthy that they'll live for a long time."

The Fine Print

With the added scrutiny of their industry, the companies that push STOLI deals have turned to ever-more creative solicitation techniques. The *Los Angeles Times* recently reported that fliers circulated by one such firm at a retirement center in San Luis Obispo County offered participants as much as $50,000, courtesy of investors who wanted to "speculate" on their life expectancies.

Dangling the possibility of generous finder fees, other companies try to entice insurance agents, financial planners and other professionals to pass along the names of their older clients. Example: the website www.spinlifeins.com, which Internet registration records show is linked to Hercsky Asset Management, based in Englewood, N.J., promises that "agents make $10,000-$100,000+ per client." (The company did not respond to phone and e-mail messages from *AARP Bulletin Today*.)

It's conceivable that an individual who bites on a STOLI offer will make out financially, but only by crossing a minefield. For starters, people sometimes unwittingly sign documents as part of a deal that gives investors unfettered access to their medical records and other personal information—and can leave them open to identity theft.

And the pile of seemingly easy money may generate a huge headache when the time comes to report it as taxable income, as the IRS is likely to expect. "If you sell your policy and get more than you paid in premiums—and in the case of STOLIs, you aren't paying any [premiums] at all—Uncle Sam is going to call that taxable income," warns attorney Darras. That's what Larry King alleges happened to him. He sold his STOLI policy for $550,000 and as a result had to pay higher taxes, he says.

And as can befall people who buy a large amount of insurance in a STOLI deal and then want additional insurance to benefit their heirs, King had difficulty obtaining coverage that he actually needed. "If you have too much coverage, you can't buy more insurance—even if you need it," explains Jack Dolan of the American Council of Life Insurers.

What if an insured person has the misfortune to die before the secretly agreed date for flipping the policy? "The STOLI people are keeping score of the money that they've invested in premiums," warns Prescott Cole, an attorney for San Francisco-based California Advocates for Nursing Home Reform. "Your heirs may have to pay back that money, with interest."

Finally, while there aren't any known cases of STOLI-related foul play, it's a dark cloud over the industry that just won't go away. Murder-for-insurance schemes, after all, make news with chilling regularity. There was the recent case, for example, of two older Los Angeles women who conspired to murder homeless men, in staged hit-and-run "accidents," for life insurance payoffs that ran into the millions of dollars.

The potential problems are reason enough for Darras to advise his clients to just say no when a STOLI investor comes knocking. What's more, for him, the creepiness factor alone is a deal breaker. "I really don't want to have some stranger out there rooting for Grandma to die," he says.

Patrick J. Kiger is a freelance writer in Takoma Park, Md.